



SUPPLEMENT FOR THE YEAR 2011 OF THE Farmers and Mechanics Fire and Casualty Ins . Co .

AUDITED FINANCIAL REPORT



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FARMERS & MECHANICS FIRE AND
CASUALTY INSURANCE, INC.

REPORT ON
STATUTORY FINANCIAL STATEMENTS
YEARS ENDED
DECEMBER 31, 2011 AND 2010

AUDITED FINANCIAL REPORT

FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
*Farmers & Mechanics Fire and
Casualty Insurance, Inc.*
Martinsburg, West Virginia

We have audited the accompanying statutory statements of admitted assets, liabilities and surplus of *Farmers & Mechanics Fire and Casualty Insurance, Inc.* as of December 31, 2011 and 2010, and the related statutory statements of operations, changes in surplus and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, these financial statements were prepared in conformity with the accounting practices prescribed or permitted by the Insurance Department of the State of West Virginia, which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the significance of the matter discussed in the preceding paragraph, the financial statements referred to in the first paragraph do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of *Farmers & Mechanics Fire and Casualty Insurance, Inc.* as of December 31, 2011 and 2010, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the financial statements referred to in the first paragraph present fairly in all material respects, the admitted assets, liabilities, and surplus of *Farmers & Mechanics Fire and Casualty Insurance, Inc.* as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

Buffamante Whipple Buttafaro, P.C.
BUFFAMANTE WHIPPLE BUTTAFARO, P.C.

Jamestown, New York
May 15, 2012

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FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
STATUTORY STATEMENTS OF ADMITTED ASSETS,
LIABILITIES AND SURPLUS

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As of December 31,	2011	2010
Admitted Assets		
Cash and Invested Assets		
Bonds	\$ 3,282,833	\$ 2,783,079
Cash, cash equivalents and short-term investments	896,031	961,513
Total cash and invested assets	4,178,864	3,744,592
Other Assets		
Accrued investment income	20,546	13,882
Uncollected premiums	2,503,885	2,041,331
Reinsurance recoverable on paid losses	117,399	94,437
Net deferred tax asset	157,838	99,137
Receivable from parent	30,353	- -
Total other assets	2,830,021	2,248,787
	\$ 7,008,885	\$ 5,993,379
Liabilities and Surplus		
Liabilities		
Losses	\$ 615,373	\$ 490,135
Loss adjustment expenses	234,245	143,429
Commissions payable	365,162	510,612
Accrued expenses	2,694	79,652
Taxes, licenses and fees	60,619	28,596
Federal income tax payable	195,071	1,928
Unearned premiums	2,194,077	1,776,337
Advance premiums	15,834	16,334
Ceded reinsurance premiums payable	117,068	63,207
Payable to parent	- -	87,917
Total liabilities	3,800,143	3,198,147
Surplus		
Common capital stock	1,200,000	1,200,000
Gross paid in and contributed surplus	1,800,000	1,800,000
Unassigned surplus	208,742	(204,768)
Total surplus	3,208,742	2,795,232
	\$ 7,008,885	\$ 5,993,379

See accompanying independent auditor's report and notes to financial statements.

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FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
STATUTORY STATEMENTS OF OPERATIONS

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For the Years Ended December 31,	2011	2010
Underwriting Income		
Premiums written	\$ 6,498,593	\$ 4,981,073
Reinsurance ceded	(2,464,885)	(1,689,954)
Change in unearned premiums	(417,740)	(591,026)
Net premiums earned	3,615,968	2,700,093
Losses incurred	1,669,192	1,213,469
Loss adjustment expenses	363,589	221,365
Other underwriting expenses	1,094,368	1,280,880
Total underwriting deductions	3,127,149	2,715,714
Net underwriting gain (loss)	488,819	(15,621)
Investment Income		
Investment income	78,487	72,594
Net realized capital gain, net of related federal income tax effect	22,884	834
Investment expenses	(9,574)	(9,653)
Net investment income	91,797	63,775
Other Expense	(7,525)	(12,433)
Net Income Before Federal Income Tax	573,091	35,721
Federal Income Tax Incurred	218,282	33,748
Net Income	\$ 354,809	\$ 1,973

See accompanying independent auditor's report and notes to financial statements.

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FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.

STATUTORY STATEMENTS OF CHANGES IN SURPLUS

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For the Years Ended December 31,	2011	2010
Surplus, Beginning	\$ 2,795,232	\$ 2,280,733
Increase to Surplus:		
Net income	354,809	1,973
Change in net deferred income tax	61,308	12,628
Change in non-admitted assets	(2,607)	(102)
Capital paid in	- -	200,000
Surplus paid in	- -	300,000
Change in surplus	413,510	514,499
Surplus, Ending	\$ 3,208,742	\$ 2,795,232

See accompanying independent auditor's report and notes to financial statements.

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FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
STATUTORY STATEMENTS OF CASH FLOWS

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For the Years Ended December 31,	2011	2010
Cash From Operations:		
Premiums collected net of reinsurance	\$ 3,624,515	\$ 2,729,422
Net investment income	69,037	58,975
Miscellaneous expense	(7,525)	(12,433)
Cash provided by operations	3,686,027	2,775,964
Benefit and loss related payments	1,566,916	998,703
Commissions, expenses paid and write-ins for deductions	1,557,526	1,193,485
Federal income taxes paid	36,928	12,477
Cash used for operations	3,161,370	2,204,665
Net cash from operations	524,657	571,299
Cash From Investments:		
Proceeds from investments sold, matured or repaid	3,434,782	1,808,000
Cost of investments acquired	(3,906,651)	(2,179,922)
Net cash from investments	(471,869)	(371,922)
Cash From Financing and Miscellaneous Sources:		
Capital and paid in surplus, less treasury stock	- -	500,000
Other cash applied	(118,270)	(824)
Change in Cash, Cash Equivalents and Short-Term Investments	(65,482)	698,553
Cash, Cash Equivalents and Short-Term Investments:		
Beginning of Year	961,513	262,960
End of Year	\$ 896,031	\$ 961,513

See accompanying independent auditor's report and notes to financial statements.

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FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
NOTES TO STATUTORY FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2011 AND 2010

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NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The *Farmers & Mechanics Fire and Casualty Insurance, Inc.* (the "Company"), a subsidiary of Farmers & Mechanics Mutual Insurance Company of West Virginia ("F & M Mutual") writes primarily auto and commercial insurance in the state of West Virginia. Products are offered through independent insurance agents, none of which represent a significant portion of the Company's business. Policies are written on a direct bill basis.

Method of Accounting

The financial statements of the Company are presented on the basis of accounting practices prescribed or permitted by the Insurance Department of West Virginia. The Insurance Department of West Virginia recognizes only statutory accounting practices prescribed or permitted by the State of West Virginia for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under the West Virginia Insurance Law. The National Association of Insurance Commissioners' ("NAIC") Accounting Practices and Procedures Manual Version effective March 2011 ("NAIC SAP") has been adopted as a component of prescribed or permitted practices by the State of West Virginia. There are no differences in surplus or net income between NAIC SAP and practices prescribed and permitted by the State of West Virginia at December 31, 2011 and 2010.

Use of Estimates

The preparation of financial statements in conformity with statutory accounting principles requires management to make estimates and assumptions that affect the reported amounts of admitted assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made by the Company include, but are not limited to, reserves for losses and loss adjustment expenses.

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash, cash equivalents, short-term investments and investments in bonds. The Company invests in bonds of U.S. institutions. The Company maintains its cash balances at financial institutions located in West Virginia and Ohio. The Company performs periodic evaluation of the relative credit standing of these financial institutions and limits the amount of credit exposure with these institutions.

Bonds

Bonds are valued pursuant to the instructions of the Securities Valuation Office of the NAIC. Generally, bonds are carried at cost adjusted for amortization of any related premium or discount. Bonds with NAIC designations of 3 through 6 are stated at the lower of amortized cost or fair value.

Mortgage-Backed/Asset-Backed Securities

Single class and multi class mortgage-backed/asset-backed securities are carried at amortized cost using the interest method including anticipated prepayments. Significant changes in estimated cash flows from the original purchase assumptions are accounted for using the prospective method. Prepayment assumptions are obtained from Bloomberg projected cash flow reports.

Cash, Cash Equivalents and Short-Term Investments

Cash and cash equivalents include highly liquid investments purchased with original maturities of three months or less at the date of acquisition and are carried at cost, which is also their fair value. Short-term investments include investments with original maturities of less than one year at the date of acquisition and are carried at amortized cost, which is also their fair value.

Repurchase Agreement

The Company has a repurchase agreement that is collateralized by federal securities. Company policy requires a minimum 100% of the fair value of the securities purchased under the repurchase agreements to be maintained as collateral.

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NOTES TO STATUTORY FINANCIAL STATEMENTS
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NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Capitalization Policy

The Company has a written capitalization policy for prepaid expenses and purchases of items such as electronic data processing equipment, software, furniture and other equipment. The predefined capitalization thresholds under this policy have not changed from those of the prior year.

Investment Impairment

The Company relies on, and communicates with, its investment manager to review the portfolio and market conditions to determine whether any individual investment securities should be items of concern. In the event a bond security falls below "2", it will be monitored and liquidated within a reasonable time frame dependent upon market conditions. Statement values ultimately are determined based on NAIC instructions for applicable bond designations. A decline in the market value of an investment security below cost judged to be other-than-temporary is recognized as a loss in the current year and reduces the cost basis of the security. In subsequent years, any realized gain or loss or any unrealized change in market value is measured against the adjusted cost basis of the investment security.

Revenue Recognition and Related Expenses

Premiums are earned ratably over the terms of the related insurance policies. Premium related to the unexpired portion of policies in force at the balance sheet date is determined using a daily pro rata method and recorded as unearned premium. On certain contracts, the reinsurer earned ceded premiums pursuant to the Company's reinsurance agreements over the duration of the original policies. The unearned portion of ceded premiums are netted against the Company's direct unearned premium.

Expenses incurred in connection with acquiring new insurance business, including such acquisition costs as sales commissions, are charged to operations as incurred. Expenses incurred are reduced for ceding allowances received or receivable.

Reinsurance recoverables are estimates of paid and unpaid losses collectible from the Company's reinsurer. The amounts ultimately collected may be more or less than these estimates. Any adjustments of these estimates are reflected in income, as they are determined. The Company periodically reviews the financial condition of its reinsurers and amounts recoverable from them, recording an allowance when necessary for uncollectible reinsurance.

Losses and Loss Adjustment Expenses

The liability for net unpaid losses and loss adjustment expenses includes an amount determined from individual case estimates and an amount, based on historical trends and development factors, for losses incurred but not reported. Such liability is necessarily based on assumptions and estimates and, while management believes the amount to be adequate, the ultimate liability may differ from that provided. The methods for making such estimates and for establishing the resulting liability is continually reviewed and any adjustments are reflected in current earnings.

Because of the nature of the business written, management believes the Company has limited exposure to environmental claim liabilities.

Other

The above practices vary in some respects from accounting principles generally accepted in the United States of America, in determining financial position and results of operations. Such significant differences include, but are not limited to:

Bonds are carried primarily at amortized cost unless required by the NAIC to be carried at market; acquisition costs, such as commissions and other items, are charged to current operations as incurred, whereas related premium income is taken into earnings on a pro rata basis over the period covered by the policies; certain assets designated as "non-admitted assets" are charged off against surplus; realized investment gains and losses are included in net income from operations, while unrealized gains and losses are credited or charged directly to surplus; reserves for losses and loss adjustment expenses and unearned premiums ceded to reinsurers have been reported as reduction of the related reserves; changes in deferred income taxes are recognized as a separate component of gains and losses in surplus; and the Company is not consolidated with the accounts and operations of its parent company.

The effect of such differences on the accompanying statutory financial statements has not been determined.

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NOTES TO STATUTORY FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2011 AND 2010

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NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Subsequent Events

Management has evaluated subsequent events through February 23, 2012, the date the Annual Statutory Statement was issued. Management has updated their evaluation of subsequent events through May 15, 2012, the date the audited financial statements were available for issuance.

NOTE 2 - INVESTMENTS

The aggregate statement value or cost, gross unrealized gains, gross unrealized losses and fair value for investments at December 31, 2011 and 2010 are as follows:

	2011			
	Statement Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government obligations	\$ 937,796	\$ 11,582	\$ --	\$ 949,378
States and political subdivisions	245,965	6,487	--	252,452
Special revenue	388,831	10,086	--	398,917
Industrial and miscellaneous	1,029,836	25,188	(832)	1,054,192
Mortgage-backed securities	680,405	5,080	(123)	685,362
Total	\$ 3,282,833	\$ 58,423	\$ (955)	\$ 3,340,301

	2010			
	Statement Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government obligations	\$ 2,074,846	\$ 16,877	\$ (21,497)	\$ 2,070,226
Special revenue	200,169	1,319	--	201,488
Industrial and miscellaneous	508,064	12,845	--	520,909
Total	\$ 2,783,079	\$ 31,041	\$ (21,497)	\$ 2,792,623

The statement value of investments in bonds at December 31, by contractual maturity, is shown below. Expected maturities may differ from contractual maturities because borrowers have the right to prepay obligations without prepayment penalties.

	2011	2010
Due one year or less	\$ 500,612	\$ 600,169
Due after one year through five years	612,584	701,975
Due after five years through ten years	944,933	707,018
Due after ten years through twenty years	374,161	773,917
Due after twenty years	170,138	--
Mortgage-backed securities	680,405	--
	\$ 3,282,833	\$ 2,783,079

A bond with a fair market value of \$100,973 and \$101,473 at December 31, 2011 and 2010, respectively, is being held as a special deposit by the Insurance Commissioner. This bond is restricted as required by law.

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YEARS ENDED DECEMBER 31, 2011 AND 2010

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NOTE 2 – INVESTMENTS (CONT'D)

Unrealized losses at December 31, 2011 are as follows:

	Less than 12 Months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Industrial and miscellaneous	\$ 181,885	\$ (832)	\$ --	\$ --	\$ 181,885	\$ (832)
Mortgage-backed securities	90,326	(123)	--	--	90,326	(123)
	<u>\$ 272,211</u>	<u>\$ (955)</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 272,211</u>	<u>\$ (955)</u>

Unrealized losses at December 31, 2010 are as follows:

	Less than 12 Months		More than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government obligations	\$ 952,420	\$ (21,497)	\$ --	\$ --	\$ 952,420	\$ (21,497)

Major categories of investment income are summarized as follows:

	2011	2010
Taxable bonds	\$ 71,665	\$ 71,477
Tax exempt bonds	6,049	--
Cash and short-term investments	773	1,117
Total investment income	<u>\$ 78,487</u>	<u>\$ 72,594</u>

Proceeds from the sales of investments in bonds during 2011 and 2010 were \$3,434,782 and \$1,808,000, respectively. Gross gains of \$34,673 and \$1,127 were realized on those sales in 2011 and 2010, respectively. No losses were realized on those sales in either year.

NOTE 3 – CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash, cash equivalents and short-term investments include the following at December 31:

	2011	2010
Cash	\$ --	\$ --
Repurchase agreement	483,469	715,101
Money market	412,562	246,412
Total	<u>\$ 896,031</u>	<u>\$ 961,513</u>

NOTE 4 - NET LOSSES AND LOSS ADJUSTMENT EXPENSES

At December 31, net unpaid losses and loss adjustment expenses consisted of the following:

	2011		2010	
	Losses	Loss Adjustment Expenses	Losses	Loss Adjustment Expenses
Direct case reserves	\$ 572,238	\$ 84,010	\$ 360,954	\$ 89,587
Reserve for incurred but not reported, net	279,000	161,000	284,000	74,000
Ceded case reserves	(235,865)	(10,765)	(154,819)	(20,158)
	<u>\$ 615,373</u>	<u>\$ 234,245</u>	<u>\$ 490,135</u>	<u>\$ 143,429</u>

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FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
NOTES TO STATUTORY FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2011 AND 2010

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NOTE 4 - NET LOSSES AND LOSS ADJUSTMENT EXPENSES (CONT'D)

Activity in the liability for unpaid losses and loss adjustment expenses is summarized as follows as of December 31:

	2011	2010
Net loss and loss adjustment expense reserves at beginning of year	\$ 633,564	\$ 493,697
Incurring related to:		
Current year losses	2,003,000	1,431,000
Prior years losses	29,781	3,834
Total incurred	2,032,781	1,434,834
Paid related to:		
Current year losses	(1,432,000)	(993,000)
Prior years losses	(384,727)	(301,967)
Total paid	(1,816,727)	(1,294,967)
Net loss and loss adjustment expense at end of year	\$ 849,618	\$ 633,564

Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years have increased by \$29,781 in 2011 as a result of re-estimation of unpaid losses and loss adjustment expenses. The change is generally the result of ongoing analysis of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual losses.

NOTE 5 – FEDERAL INCOME TAXES

The federal income tax returns of the Company for 2011, 2010 and 2009 are subject to examination by the Internal Revenue Service, generally for three years after they were filed. An income tax position may create an income tax contingency for the Company. As of December 31, 2011 and 2010, there were no income tax positions that create an income tax contingency. The Company records deferred tax assets and deferred tax liabilities for certain temporary differences between statutory basis income before federal income taxes, plus certain items recorded directly to surplus and taxable income as reflected in the Company's federal income tax return, subject to certain limitations.

The amount of gross deferred tax assets and deferred tax liabilities comprising net deferred tax assets is shown below as well as admitted, non-admitted and change in non-admitted deferred tax assets.

	2011			2010			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Gross deferred tax assets	\$ 164,685	\$ -	\$ 164,685	\$ 103,799	\$ -	\$ 103,799	\$ 60,886	\$ -	\$ 60,886
Statutory valuation allowance adjustment	-	-	-	-	-	-	-	-	-
Adjusted gross deferred tax assets	164,685	-	164,685	103,799	-	103,799	60,886	-	60,886
Deferred tax liabilities	(105)	-	(105)	(527)	-	(527)	422	-	422
Net deferred tax assets (liabilities)	164,580	-	164,580	103,272	-	103,272	61,308	-	61,308
Non-admitted deferred tax assets	(6,742)	-	(6,742)	(4,135)	-	(4,135)	(2,607)	-	(2,607)
Net admitted deferred tax assets/(liabilities)	\$ 157,838	\$ -	\$ 157,838	\$ 99,137	\$ -	\$ 99,137	\$ 58,701	\$ -	\$ 58,701

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NOTES TO STATUTORY FINANCIAL STATEMENTS
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NOTE 5 - FEDERAL INCOME TAXES (CONT'D)

As of December 31, the Company had no unrecognized deferred income tax liabilities. The Company has not elected to admit additional deferred tax assets pursuant to Statement of Statutory Accounting Principle No. 10R for the years ended December 31, 2011 and 2010.

The amount of admitted gross deferred tax assets, by tax character, under each component of SSAP 10 at December 31, 2011 and 2010 are as follows:

	2011			2010			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Admission calculation components - SSAP 10, paragraphs 10.a., 10.b., and 10.c.:									
Recovered through loss carryback 10.a	\$ 131,745	\$ -	\$ 131,745	\$ 26,518	\$ -	\$ 26,518	\$ 105,227	\$ -	\$ 105,227
Lesser of paragraph 10.b.i and 10.b.ii	26,093	-	26,093	72,619	-	72,619	(46,526)	-	(46,526)
Deferred tax asset offset against deferred tax liabilities 10.c.	105	-	105	527	-	527	(422)	-	(422)
Total admitted deferred tax assets under paragraph 10.a, 10.b, 10.c	\$ 157,943	\$ -	\$ 157,943	\$ 99,664	\$ -	\$ 99,664	\$ 58,279	\$ -	\$ 58,279

The ten percent of adjusted capital and surplus used for paragraph 10.b.ii of Statement of Statutory Accounting Principle Number 10 was \$302,058 and \$274,484 for 2011 and 2010 respectively. Paragraph 10.b.ii did not apply to 2011 and 2010.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31 are as follows:

	2011	2010	Change
Deferred tax assets:			
Ordinary:			
Discounting of unpaid losses and loss adjustment expense	\$ 14,411	\$ 10,222	\$ 4,189
Unearned and advance premiums	150,274	93,577	56,697
Subtotal	164,685	103,799	60,886
Statutory valuation allowance adjustment	--	--	--
Non-admitted deferred tax assets	(6,742)	(4,135)	(2,607)
Admitted ordinary deferred tax assets	157,943	99,664	58,279
Admitted deferred tax assets	157,943	99,664	58,279
Deferred tax liabilities:			
Ordinary-other	(105)	(527)	422
Net deferred tax asset	\$ 157,838	\$ 99,137	\$ 58,701

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NOTE 5 - FEDERAL INCOME TAXES (CONT'D)

The components of income tax expense incurred are as follows as of December 31:

	2011	2010
Current income tax expense	\$ 220,209	\$ 33,748
Realized capital gains tax	11,789	293
Prior year accrual change	(1,927)	--
Federal income tax expense	\$ 230,071	\$ 34,041

Amounts reported as income before federal income tax for statutory reporting purposes vary from income for federal income tax purposes. The principal differences include loss reserve discounting, deferral of the deduction for estimated acquisition costs associated with unearned premiums and changes in the effective tax rate used for deferred income taxes.

The Company does not file a consolidated federal income tax return with its parent company, F & M Mutual Insurance Company of West Virginia.

Income tax incurred of approximately \$230,000 and \$32,000 for 2011 and 2010, respectively, is available for recoupment in the event of future net losses.

NOTE 6 - REINSURANCE

The Company limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risks with other insurers or reinsurers, either on an automatic basis under general reinsurance contracts known as "treaties" or by negotiation on substantial individual risks. Ceded reinsurance is treated as the risk and liability of the assuming companies.

In the event that all or any of the reinsuring companies might be unable to meet their obligations under existing reinsurance agreements, the Company would be liable for such defaulted amounts. Net estimated amounts recoverable from reinsurers are as follows at December 31:

	2011	2010
Ceded losses and loss adjustment expense	\$ 477,630	\$ 412,977
Ceded unearned premiums	1,321,358	1,077,643
Reinsurance recoverable on loss and loss adjustment expense payments	117,399	94,437
Ceded premiums payable	(117,068)	(63,207)
Ceded taxes, expenses and other obligations	102,658	(43,954)
	\$ 1,901,977	\$ 1,477,896

Unsecured reinsurance recoverables at December 31, 2011 and 2010, that exceed 3% of the Company's capital and surplus are summarized as follows:

	2011	2010
Arch Reinsurance Company	\$ 1,937,000	\$ 1,517,000

The Company had approximately \$454,000 and \$368,000 of commission equity in surplus as a result of ceded activity at December 31, 2011 and 2010, respectively. Additional or return commissions accrued at December 31, 2011, based on loss experience or other profit sharing arrangements, are \$30,915 of direct contingent commission and \$(102,658) of ceded sliding scale commissions.

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NOTE 7- COMMON CAPITAL STOCK

The Company has 500,000 shares of \$8 par value common stock authorized and 150,000 and shares issued and outstanding at December 31, 2011 and 2010. All outstanding shares of the Company are owned by F & M Mutual.

On June 11, 2010, the Company issued an additional 25,000 shares of common stock at \$20 per share, totaling \$500,000 to its parent, F & M Mutual.

NOTE 8 - RELATED PARTY

The Company and F & M Mutual have certain common officers and board of directors, and share common operational management. All employees are employed by F & M Mutual. The Company reimburses F & M Mutual under a cost sharing agreement that stipulates allocation of personnel cost, along with specific overhead expenses, based on a variety of different factors.

F & M Mutual maintains a 401(k) defined contribution employees' retirement and savings plan for all eligible employees. Employee contributions are voluntary and F & M Mutual matches 50% of the employee contributions up to a maximum of 3% of gross wages. F & M Mutual contributed \$50,578 and \$48,933 for the periods ended December 31, 2011 and 2010, respectively.

Approximate balances and transactions between the Company and F & M Mutual were as follows:

	2011	2010
Receivable from (Payable to) F & M Mutual	\$ 30,353	\$ (87,917)
Expenses reimbursed to F & M Mutual by the Company	\$ 788,000	\$ 618,000

NOTE 9 - FAIR VALUE MEASUREMENTS

The fair value of the Company's financial instruments approximate their carrying amounts, either because the expected collection or payment period is relatively short or because the terms are similar to market terms. A fair value hierarchy exists that prioritizes the inputs to valuation techniques used to measure fair value. The Company uses appropriate valuation techniques based on available inputs to measure the fair value of assets and liabilities.

AUDITED FINANCIAL REPORT

SUPPLEMENTARY INFORMATION

AUDITED FINANCIAL REPORT



INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

To the Board of Directors
*Farmers & Mechanics Fire and
Casualty Insurance, Inc.*
Martinsburg, West Virginia

We have audited the statutory financial statements of *Farmers & Mechanics Fire and Casualty Insurance, Inc.* for the years ended December 31, 2011 and 2010, and our report thereon dated May __, 2012 appears on page 1. Our audits were conducted for the purpose of forming an opinion on the basic statutory financial statements taken as a whole. The accompanying statutory schedules of loss adjustment, underwriting and investment expenses for the years ended December 31, 2011 and 2010, and summary investment schedule and investment risks interrogatories as of December 31, 2011, are presented for the purpose of additional analysis and are not a required part of the basic statutory financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the statutory financial statements. The information has been subjected to the auditing procedures applied in the audit of the statutory financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the statutory financial statements or to the statutory financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in conformity with accounting practices prescribed or permitted by the Insurance Department of West Virginia and is fairly stated in all material respects in relation to the statutory financial statements taken as a whole.

Buffamante Whipple Buttafaro, P.C.
BUFFAMANTE WHIPPLE BUTTAFARO, P.C.

Jamestown, New York
May 15, 2012

AUDITED FINANCIAL REPORT

FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
STATUTORY SCHEDULES OF LOSS ADJUSTMENT, UNDERWRITING
AND INVESTMENT EXPENSES

Page 15

For the Years Ended December 31,	2011				2010
	Loss Adjustment Expenses	Other Underwriting Expenses	Investment Expenses	Total	Total
Net claim adjustment services	\$ 177,231	\$ --	\$ --	\$ 177,231	\$ 98,492
Net commissions	--	25,163	--	25,163	297,680
Advertising	--	24,761	--	24,761	12,932
Boards, bureaus and associations	--	40,041	--	40,041	24,050
Surveys and underwriting reports	--	151,078	--	151,078	120,888
Salaries	109,682	342,049	790	452,521	377,371
Payroll taxes	8,153	25,427	59	33,639	29,220
Employee relations and welfare	15,903	49,594	115	65,612	65,010
Insurance	476	1,485	3	1,964	2,092
Travel and travel items	4,135	12,896	30	17,061	12,399
Rent and rent items	20,976	65,416	151	86,543	65,557
Equipment	2,267	7,070	16	9,353	5,784
EDP equipment and software	12,243	38,180	88	50,511	137,402
Printing and stationery	2,647	8,256	19	10,922	6,668
Postage and telephone	5,636	17,578	41	23,255	17,465
Legal and auditing	4,240	13,223	31	17,494	22,359
Taxes, licenses and fees	--	272,151	--	272,151	207,867
Investment expense	--	--	8,231	8,231	8,662
	\$ 363,589	\$ 1,094,368	\$ 9,574	\$ 1,467,531	\$ 1,511,898

See accompanying independent auditor's report on supplementary information.

AUDITED FINANCIAL REPORT

FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
SUMMARY INVESTMENT SCHEDULE
AS OF DECEMBER 31, 2011

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	Gross Investment Holdings	
	Amount	Percentage
Bonds:		
U.S. Treasury securities	\$ 513,522	12.289%
U.S. government agency obligations:		
Issued by U.S. government sponsored agencies	424,274	10.153%
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:		
States, territories and possessions general obligations	91,746	2.20%
Political subdivisions of states, territories and possessions and political subdivisions general obligations	154,219	3.69%
Revenue and assessment obligations	388,831	9.305%
Mortgage-backed securities:		
Pass through securities-issued by guaranteed by FNMA and FHLMC	383,130	9.168%
CMO's and REMICs - all other	176,684	4.228%
Other Debt and Other Fixed Income Securities:		
Domestic securities - unaffiliated	1,115,890	26.703%
Unaffiliated non-U.S. securities	34,537	0.826%
Cash, Cash Equivalents and Short-Term Investments	896,031	21.442%
	\$ 4,178,864	100.000%

There was no difference between gross investment holdings and admitted assets as reported in the annual statement.

See accompanying independent auditor's report on supplementary information.

AUDITED FINANCIAL REPORT

FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
INVESTMENT RISKS INTERROGATORIES
AS OF DECEMBER 31, 2011

Page 17

1. State the reporting entity's total admitted assets as reported on Page 2 of annual statements.
- \$7,008,885
2. State by investment category the 10 largest exposures to a single issuer/user/borrower/investment, excluding U.S. government, U.S. government agency securities and those U.S. government money market funds listed in the Appendix to the SVO Purposes and Procedures Manual as exempt, property occupied by the company and policy loans.

Issuer	Description of Exposure	Amount	Percentage of Total Admitted Assets
John Deere Capital Corp	BOND	\$ 200,664	2.863%
Goldman Sachs Group	BOND	\$ 199,971	2.853%
Pharmicia Corp	BOND	\$ 107,224	1.530%
University of Minnesota Higher Ed	MUNI BOND	\$ 66,318	0.946%
Allen Tex Indpt Sch Dist	MUNI BOND	\$ 64,485	0.920%
Virginia Port Auth Comwlth	MUNI BOND	\$ 64,284	0.917%
University Calif Revs	MUNI BOND	\$ 63,356	0.904%
Louisville & Jefferson Cnty KY	MUNI BOND	\$ 63,292	0.903%
Maine St Muni Bond	MUNI BOND	\$ 60,496	0.863%
FL State Board of Ed	MUNI BOND	\$ 58,730	0.838%

3. State the amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC rating.

Bonds		
NAIC-1	\$ 3,639,426	51.926%
NAIC-2	\$ 55,969	0.799%

4. N/A
5. N/A
6. N/A
7. N/A
8. N/A
9. N/A
10. N/A
11. N/A
12. N/A

See accompanying independent auditor's report on supplementary information.

AUDITED FINANCIAL REPORT

FARMERS & MECHANICS FIRE AND CASUALTY INSURANCE, INC.
INVESTMENT RISKS INTERROGATORIES (CONT'D)
AS OF DECEMBER 31, 2011

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13. N/A
14. N/A
15. N/A
16. N/A
17. N/A
18. N/A
19. N/A
20. State the amounts and percentages of the reporting entity's total admitted assets subject to repurchase agreements:

<u>December 31, 2011</u>	<u>Percentage of Total Admitted Assets</u>	<u>March 31, 2011</u>	<u>June 30, 2011</u>	<u>September 30, 2011</u>
\$ 438,469	6.898%	\$ 757,345	\$ 863,247	\$ 664,738

21. N/A
22. N/A
23. N/A

See accompanying independent auditor's report on supplementary information.

AUDITED FINANCIAL REPORT

Private Companies Practice Section



BUFFAMANTE WHIPPLE BUTTAFARO, P.C.

Certified Public Accountants • Business Advisors

REPORT ON INTERNAL CONTROLS

To the Board of Directors

***Farmers & Mechanics Fire and
Casualty Insurance, Inc.***
Martinsburg, West Virginia

In planning and performing our audit of the financial statements of *Farmers & Mechanics Fire and Casualty Insurance, Inc.* as of and for the year ended December 31, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered *Farmers & Mechanics Fire and Casualty Insurance, Inc.'s* internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatement on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and, therefore, there can be no assurance that all such deficiencies have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

This communication is intended solely for the information and use of the Board of Directors, management, others within *Farmers & Mechanics Fire and Casualty Insurance, Inc.*, and for purposes of filing with the Insurance Department of West Virginia and is not intended to be and should not be used by anyone other than these specified parties.

Buffamante Whipple Buttafaro, P.C.

BUFFAMANTE WHIPPLE BUTTAFARO, P.C.

**Jamestown, New York
May 15, 2012**

AUDITED FINANCIAL REPORT



INDEPENDENT AUDITOR'S ANNUAL LETTER OF QUALIFICATIONS

To the Board of Directors
*Farmers & Mechanics Fire and
Casualty Insurance, Inc.*
Martinsburg, West Virginia

We have audited, in accordance with auditing standards generally accepted in the United States of America, the statutory financial statements of *Farmers & Mechanics Fire and Casualty Insurance, Inc.* for the year ended December 31, 2011, and have issued our report thereon dated May 15, 2012. In connection therewith, we advise you as follows:

- » We are independent certified public accountants with respect to the Company and conform to the standards of the accounting profession as contained in the Code of Professional Conduct and pronouncements of the American Institute of Certified Public Accountants and the Rules of Professional Conduct of the New York State Board for Public Accountancy.
- » The engagement shareholder, who is a certified public accountant, has 31 years of experience in public accounting and is experienced in auditing insurance entities. Members of the engagement team, all of whom have had experience in auditing insurance entities, were assigned to perform tasks commensurate with their training and experience.
- » We understand that the Company intends to file its audited statutory financial statements and our report thereon with the Insurance Department of West Virginia and that the Insurance Commissioner will be relying on that information in monitoring and regulating the statutory financial condition of the Company.

While we understand that an objective of issuing a report on the statutory financial statements is to satisfy regulatory requirements, our audit was not planned to satisfy all objectives or responsibilities of insurance regulators. In this context, the Company and the Insurance Commissioner should understand that the objective of an audit of statutory financial statements in accordance with auditing standards generally accepted in the United States of America is to form an opinion and issue a report on whether the statutory financial statements present fairly in all material respects, the admitted assets, liabilities, and capital and surplus, results of operations and cash flow in conformity with the accounting practices prescribed or permitted by the Insurance Department of West Virginia. Consequently, under auditing standards generally accepted in the United States of America, we have the responsibility, within the inherent limitations of the auditing process, to plan and perform our audit to obtain reasonable assurance about whether the statutory financial statements are free of material misstatement, whether caused by error or fraud, and to exercise due professional care in the conduct of the audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Audit procedures that are effective for detecting errors, if they exist, may be ineffective for detecting misstatements resulting from fraud. Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement resulting from fraud. In addition, an audit does not address the possibility that material misstatements caused by error or fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may exist that would have been assessed differently by the Insurance Commissioner.

It is the responsibility of the management of the Company to adopt sound accounting policies, to maintain an adequate and effective system of accounts, and to establish and maintain internal control that will, among other things, provide reasonable but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting practices prescribed or permitted by the Insurance Department of West Virginia.

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Members of American Institute of Certified Public Accountants
Private Companies Practice Section

AUDITED FINANCIAL REPORT

The Insurance Commissioner should exercise due diligence to obtain whatever other information that may be necessary for the purpose of monitoring and regulating the statutory financial position of insurers and should not rely solely upon the independent auditor's report.

- » We will retain the workpapers prepared in the conduct of our audit for eight years or until the Insurance Department of West Virginia has filed a Report of Examination covering 2011, whichever is longer. After notification to the Company, we will make the workpapers available for review by the Insurance Department of West Virginia at the offices of the insurer, at our offices, at the Insurance Department or at any other reasonable place designated by the Insurance Commissioner. Furthermore, in the conduct of the aforementioned periodic review by the Insurance Department of West Virginia, photocopies of pertinent audit workpapers may be made (under the control of the accountant) and such copies may be retained by the Insurance Department of West Virginia.
- » This is the first year the engagement shareholder has served in that capacity with respect to this Company. He is licensed by the New York State Board of Accountancy and is a member in good standing of the American Institute of Certified Public Accountants.
- » To the best of our knowledge and belief, we are in compliance with the requirements of West Virginia Code 33-33-5(c) regarding qualifications of independent certified public accountants.

This letter is intended solely for the information and use of the Insurance Department of West Virginia and is not intended to be and should not be used for anyone other than this specified party.

Buffamante Whipple Buttafaro, P.C.

BUFFAMANTE WHIPPLE BUTTAFARO, P.C.

Jamestown, New York
May 15, 2012